

Edgar Filing: NEWTEK BUSINESS SERVICES INC - Form 10-Q

NEWTEK BUSINESS SERVICES INC
Form 10-Q
May 14, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER: 001-16123

NEWTEK BUSINESS SERVICES, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEW YORK

11-3504638

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER
IDENTIFICATION NO.)

100 QUENTIN ROOSEVELT BOULEVARD, GARDEN CITY, NY 11530

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (516) 390-2260

CHECK WHETHER THE REGISTRANT HAS (1) FILED ALL DOCUMENTS AND REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(D) OF THE EXCHANGE ACT DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST NINETY DAYS.

YES NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS AN ACCELERATED FILER (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES NO

AS OF MAY 12, 2004, 26,671,976 SHARES OF COMMON STOCK WERE ISSUED AND OUTSTANDING.

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ITEM 1. FINANCIAL STATEMENTS

NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
MARCH 31, 2004 (UNAUDITED) AND DECEMBER 31, 2003

A S S E T S

Cash and cash equivalents
Restricted cash
Credits in lieu of cash
SBA loans receivable, net of reserve for loan losses
Accounts receivable (net of allowance of \$38,523 and \$96,480, respectively)
Receivable from bank
SBA loans held for sale

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Accrued interest receivable
 Investments in qualified businesses - equity method investments
 Investments in qualified businesses - held to maturity investments
 Structured insurance product
 Prepaid insurance
 Prepaid expenses and other assets
 Capitalized servicing asset (net of accumulated amortization of \$89,550 and \$24,545,
 respectively)
 Furniture, fixtures and equipment (net of accumulated depreciation of \$464,875 and
 \$390,011, respectively)
 Customer merchant accounts (net of accumulated amortization of \$419,832 and \$269,380,
 respectively)
 Goodwill

 Total assets

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities:

Accounts payable and accrued expenses
 Notes payable - certified investors
 Notes payable - insurance
 Notes payable - other
 Bank notes payable
 Note payable in credits in lieu of cash
 Deferred tax liability

Total liabilities

Minority interest

Commitments and contingencies

Shareholders' equity:

Common stock (par value \$0.02 per share; authorized 39,000,000 shares, issued and
 outstanding 26,651,976 and 26,209,211, not including 582,980 shares held in escrow)
 Additional paid-in capital
 Unearned compensation
 Retained earnings

Total shareholders' equity

Total liabilities and shareholders' equity

See accompanying notes to these unaudited consolidated financial statements.

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NEWTEK BUSINESS SERVICES, INC., AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
 FOR THE THREE MONTHS ENDED MARCH 31, 2004, AND 2003

	2004	2003
	-----	-----
Revenue:		
Income from tax credits	\$ 2,023,525	\$ 10,388,583
Electronic payment processing	3,232,504	847,804

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Servicing fee and premium income	1,112,367	368,447
Interest and dividend income	1,028,948	1,059,169
Other income	473,149	255,441
	-----	-----
Total revenue	7,870,493	12,919,444
	-----	-----
Expenses:		
Interest	3,764,774	3,717,852
Payroll and consulting fees	2,185,449	1,664,064
Electronic payment processing costs	2,100,986	1,119,942
Professional fees	994,609	915,767
Insurance	714,962	573,293
Other than temporary decline in value of investments	--	1,713,414
Equity in net losses of affiliates	--	54,974
Provision for loan losses	104,681	--
Other	1,193,576	706,513
	-----	-----
Total expenses	11,059,037	10,465,819
	-----	-----
(Loss) income before minority interest, provision for income taxes and extraordinary items	(3,188,544)	2,453,625
Minority interest in income	300,314	288,337
	-----	-----
(Loss) income before provision for income taxes and extraordinary items	(2,888,230)	2,741,962
Benefit (provision) for income taxes	1,184,174	(1,069,365)
	-----	-----
(Loss) income before extraordinary items	(1,704,056)	1,672,597
Extraordinary gain on acquisition of a business	--	186,729
	-----	-----
Net (loss) income	\$ (1,704,056)	\$ 1,859,326
	-----	-----
Weighted average common shares outstanding		
Basic	26,471,248	25,409,868
Diluted	26,471,248	25,661,450
Net (loss) income per share		
Basic	\$ (.06)	\$.07
Diluted	\$ (.06)	\$.07
(Loss) income per share before extraordinary items		
Basic	\$ (.06)	\$.07
Diluted	\$ (.06)	\$.07

See accompanying notes to these unaudited consolidated financial statements.

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	2004	2003
	-----	-----
Cash flows from operating activities:		
Net (loss) income	\$(1,704,056)	1,859,326
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Other than temporary decline in value of investments, net of recoveries	--	1,713,414
Equity in losses of affiliates	--	54,974
Extraordinary gain on acquisition of business	--	(186,729)
Income from tax credits	(2,023,525)	(10,388,583)
Deferred income taxes	(1,184,174)	1,069,365
Depreciation and amortization	290,321	45,027
Provision for loan losses	104,681	--
SBA loans originated for sale	(8,111,992)	--
Proceeds from sale of SBA loans	9,449,200	--
Accretion of interest income	(43,904)	(43,904)
Accretion of interest expense	3,021,416	3,091,022
Non-cash compensation	261,588	104,925
Minority interest	(300,314)	(288,338)
Changes in assets and liabilities, net of the effect of business acquisitions:		
Prepaid insurance	(122,312)	463,323
Discount on loan originations, net	256,269	--
Prepaid expenses, accounts receivable and other assets	(1,336,796)	45,447
Accounts payable and accrued expenses	(162,715)	128,763
	-----	-----
Net cash used in operating activities	(1,606,313)	(2,331,968)
	-----	-----
Cash flows from investing activities:		
Investments in qualified businesses (consolidated entities)	(282,352)	(3,200,000)
Return of investments - held to maturity	136,122	58,052
Return of investments - consolidated entities	1,614,806	1,518,483
Consolidation of majority owned entities	(1,332,454)	1,408,890
Purchase of furniture, fixtures and equipment	(216,482)	(12,478)
SBA Loans originated for investment	(3,138,056)	--
Payments received on SBA loans	2,353,900	2,307,414
Other investments	(15,449)	--
	-----	-----
Net cash (used in) provided by investing activities	(879,965)	2,080,361
	-----	-----

See accompanying notes to these unaudited consolidated financial statements.

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Cash flows from financing activities:

Proceeds from issuance of notes payable to certified investors	\$ 10,925,483
Cash paid for Coverage A	(3,347,461)
Principal payments of note payable-insurance	(778,716)
Repayments of note payable - bank and other	(120,000)
Proceeds from sale of preferred stock of subsidiary	--
Change in restricted cash	(573,209)
Proceeds from SBA bank notes payable	3,651,980
Net proceeds from exercise of stock options	546,069
Net proceeds from issuance of common stock	1,301,592

Net cash provided by financing activities	11,605,738

Net increase in cash and cash equivalents	9,119,460
Cash and cash equivalents - beginning of period	33,444,611

Cash and cash equivalents - end of period	\$ 42,564,071

SUPPLEMENTAL DISCLOSURE OF CASH FLOW ACTIVITIES:

Reduction of credits in lieu of cash and notes payable in credits in lieu of cash balances due to delivery of tax credits to Certified Investors	\$ 4,820,604

Issuance of notes in partial payment for insurance	\$ 3,000,000

Issuance of warrant in connection with purchase of Coverage A Insurance	\$ 250,000

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NEWTEK BUSINESS SERVICES, INC. AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

BASIS OF PRESENTATION AND DESCRIPTION OF BUSINESS

The consolidated financial statements of Newtek Business Services, Inc. and Subsidiaries (the "Company" or "Newtek") included herein have been prepared by us pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and include all majority owned subsidiaries or those which Newtek is considered to be the primary beneficiary of (as defined under FASB Interpretation No. FIN 46 ("FIN 46")). All intercompany balances and transactions have been eliminated in consolidation. The financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in our Form 10-K for the fiscal year ended December 31, 2003, as amended.

The unaudited consolidated financial statements of Newtek, reflect, in the opinion of management, all adjustments necessary to present fairly the

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financial position of Newtek at March 31, 2004, the results of operations and its cash flows for the three months ended March 31, 2004. Results of operations for the interim periods may not be representative of results to be expected for a full year. All adjustments are of a normal recurring nature.

Newtek Business Services, Inc., is engaged in the business of providing financial products and business services to small and medium-sized businesses through ownership and/or operation of specific primary lines of business as well as organizing certified capital companies ("capcos") and investing funds made available under the capco programs in small businesses.

The following is a summary of each Capco or Capco fund, state of certification and date of certification:

CAPCO	STATE OF CERTIFICATION	DATE OF CERTIFICATION
-----	-----	-----
WA	New York	May 1998
WP	Florida	December 1998
WI	Wisconsin	October 1999
WLA	Louisiana	October 1999
WA II	New York	April 2000
WNY III	New York	December 2000
WC	Colorado	October 2001
WAP	Alabama	February 2004

The State of Louisiana has four "capco funds" which are all a part of and consolidated with the WLA Capco (the first fund). The second, Wilshire Louisiana Partners II, LLC (WLPPII), and the third, Wilshire Louisiana Partners III, LLC (WLPPIII), were formed in October 2001, and October 2002, respectively. The fourth, Wilshire Louisiana Partners IV, LLC (WLPPIV) was formed in October 2003. In general, the Capcos issue debt and equity instruments, generally warrants or shares of common stock ("Certified Capital"), to insurance company investors ("Certified Investors"). The Capcos then make targeted investments ("Investments in Qualified Businesses", as defined under the respective state statutes, or, "Qualified Businesses"), with the Certified Capital raised. Such investments may be accounted for as either consolidated subsidiaries, under the equity method or cost method of accounting, depending upon the nature of the investment and the Company's and/or the Capco's ability to control or otherwise exercise significant influence over the investee. Participation in each Capco program legally

NOTE 1- SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

entitles the Capco to receive (or earn) tax credits from the state upon satisfying quantified, defined investment percentage thresholds and time requirements. In order for the Capcos to maintain their state-issued certifications, the Capcos must make Investments in Qualified Businesses in accordance with these requirements. These state requirements are mirrored in the limitations agreed to by each Capco in its written agreements with its Certified Investors and limit the activities of the Capcos to conducting the business of a capco. Each Capco also has separate, legal contractual arrangements with the Certified Investors obligating the Capco to refrain from unauthorized activities, to use the proceeds from the notes only for Capco-authorized (i.e., "qualified") investments, to limit fees for professional services related to making, buying or selling investments to \$200,000 per Capco annually; and to pay interest on the aforementioned debt instruments whether or not it meets the statutory requirements for Investments in Qualified Businesses.

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The Capco can satisfy this interest payment, at the Capco's discretion, by delivering tax credits in lieu of paying cash. The Capcos legally have the right to deliver the tax credits to the Certified Investors. The Certified Investors legally have the right to receive and use the tax credits and would, in turn, use these tax credits to reduce their respective state tax liabilities in an amount usually equal to 100% (WLA, WLP11, and WLP111 -110%) of their certified investment. The tax credits can be utilized over a ten-year period at a rate of 10% (WLA, WLP11, and WLP111 - 11%) per year and in some instances are transferable and can be carried forward.

During February 2004, Newtek closed on its twelfth capco, Wilshire Alabama Partners LLC, for total certified capital of \$11,111,111.

CASH AND CASH EQUIVALENTS

In the Company's Statement of Cash Flows, cash invested in consolidated entities is presented as a cash outflow, and cash in those entities is presented as an inflow, "Consolidation of majority owned entities."

The Company recognizes income from tax credits as its capcos make qualified investments and satisfy statutory investment percentage thresholds within specified time requirements. Newtek believes that the presentation in the statement of cash flows of gross investments made is appropriate since it provides disclosure of the aggregate amount of investment activity during the reporting period, thus providing the information relative to achieving the Company's investment thresholds and the corresponding recognition of income from tax credits.

STOCK - BASED COMPENSATION

The Company has elected to continue using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for employee stock options. With regard to stock options, no stock-based employee compensation cost is reflected in net (loss) income, as all options granted under this plan had an exercise price equal to the market value of the underlying common stock at the date of grant. Compensation expense on restricted shares granted to employees is measured at the fair market value on the date of grant and recognized in the consolidated statements of operations on a pro-rata basis over the service period which approximates the vesting period.

The following table summarizes the pro forma consolidated results of operations of the Company as though the fair value based accounting method in SFAS 148 "Accounting for Stock-based Compensation-Transition and Disclosure- an amendment of SFAS 123" had been used in accounting for employee stock options.

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

	THREE MONTHS ENDED MARCH 31, 2004	THREE MONTHS ENDED MARCH 31, 2003
As reported		
Net (loss) income	\$ (1,704,056)	\$ 1,859,326
dd: Total stock based employee compensation expense		
A recognized, net of related tax effects	143,101	--
	-----	-----

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Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(208,262)	(212,988)
	-----	-----
Pro forma net (loss) income	\$ (1,769,217)	\$ 1,646,338
	-----	-----
Earnings per share:		
Basic - as reported	\$ (0.06)	\$.07
	-----	-----
Basic - pro forma	\$ (0.07)	\$.06
	-----	-----
Diluted - as reported	\$ (0.06)	\$.07
	-----	-----
Diluted - pro forma	\$ (0.07)	\$.06
	-----	-----

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

For the three months ended March 31, 2004 and 2003, the weighted average fair value of each option granted is estimated on the date of grant using the Black Scholes model with the following assumptions: expected volatility ranging from 59-85%, risk-free interest rate ranging from 1.61% to 6.15%, respectively, expected dividends of \$0 and expected terms ranging from 1-6 years.

USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting period. The most significant estimates are with respect to valuation of investments in qualified businesses, goodwill impairment valuation and loans receivable. Actual results could differ from those estimates.

NEW ACCOUNTING PRONOUNCEMENTS

In March 2004, the Emerging Issues Task Force ("EITF" or the "Task Force") reached a final consensus on Issue 03-6 "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share" which addresses a number of questions regarding the computation of earnings per share ("EPS") by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating EPS. It clarifies what constitutes a participating security and how to apply the two-class method of computing EPS once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. The Company does not anticipate that adoptions of this standard will have a significant impact on the Company's financial position, results of operations or cash flows.

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In March 2004, the EITF reached consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" regarding disclosures about unrealized losses on available-for-sale debt and equity securities accounted for under FASB Statements No. 115, "Accounting for Certain Investments in Debt and Equity Securities", and No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations". The guidance for evaluating whether an investment is other-than-temporarily impaired should be applied in such evaluations made in reporting periods beginning after June 15, 2004. The disclosures are effective in annual financial statements for fiscal years ending after December 15, 2003, for investments accounted for under Statements 115 and 124. For all other investments within the scope of this Issue, the disclosures are effective in annual financial statements for fiscal years ending after June 15, 2004. The additional disclosures for cost method investments are effective for fiscal years ending after June 15, 2004. We do not expect that the implementation of EITF 03-1 will have a material effect on our financial statements.

RECLASSIFICATIONS

Certain prior period amounts have been reclassified to conform to current period presentation.

NOTE 2 - COMMON STOCK:

In the first quarter of 2004, Newtek sold 201,273 shares of common stock in private transactions, with proceeds totaling approximately \$942,000. During the same period there were 153,992 stock options exercised, with proceeds totaling approximately \$547,000. In connection with the funding of the Wilshire Alabama capco, 85,500 shares of stock were issued for approximately \$359,000. In addition, 2,000 shares of common stock were issued in consideration for consulting services rendered, valued at approximately \$14,000.

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NOTE 3 - INVESTMENTS IN QUALIFIED BUSINESSES:

The following table is a summary of investments as of March 31, 2004, shown separately between their debt and equity components, and all terms of each are summarized. There are no expiration dates on any of the financial instruments, unless disclosed.

The various interests that the Company acquires in its qualified investments are accounted for under three methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on the Company's voting interest, or the economics of the transaction if the investee is determined to be a variable interest entity.

DEBT INVESTMENTS

INVESTEE	DIRECT CREATIONS, LLC -----	AUTOTASK GROUP -----	LOUISIANA BIDCO LOANS -----	TOTAL -----
INVESTMENT DATE (S)	EPT -01, NOV-01	OCT-02	VARIOUS	

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MATURITY DATE (S)	JUNE-04	SEPT-3	VARIOUS	
INTEREST RATE	S LIBOR	7.75%	PRIME +1%	
Principal outstanding at December 31, 2003	\$ 269,387	\$ 300,000	\$ 850,792	\$ 1,420,179
Return of principal - 2004	(62,495)	-	(73,627)	(136,122)
Principal outstanding at March 31, 2004	\$ 206,892	\$ 300,000	\$ 777,165	\$ 1,284,057

EQUITY INVESTMENTS

INVESTEE	BUY SEASONS, INC.	DISTRIBUTION VIDEO AND AUDIO CORP.	TOTAL
INVESTMENT DATE (S)	JUN-01	JUN-00	
TYPE OF INVESTMENT	COMMON STOCK	COMMON STOCK	
OWNERSHIP INTERST AS OF DECEMBER 31, 2002			